

BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of  
J. W. SEFTON, JR.

Appearances:

For Appellant: Thomas G. Cross, Certified Public  
Accountant

For Respondent: Burl D. Lack, Chief Counsel;  
Jack Rubin, Assistant Counsel

O P I N I O N

This appeal by J. W. Sefton, Jr., is made pursuant to Section 18593 of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying his protest against a proposed assessment of additional personal income tax in the amount of \$327.89 for the year 1952.

Appellant is in the banking business and during all of the period referred to herein he was an officer of a metropolitan bank. In 1933 Appellant married Minna Gombell. Prior to their marriage Appellant suggested that Miss Gombell open an account in the bank of which he was an officer and offered, without charge, to manage her securities and invest her funds. She agreed to this arrangement and executed a power of attorney prepared by Appellant under authority of which he managed and controlled her property and funds from 1931 to 1947.

In late 1946 Appellant and Mrs. Sefton separated and in 1947 she requested an accounting of his transactions with her funds and property. After some controversy Mrs. Sefton in 1949 filed an action against Appellant\* This suit was tried in 1952 and the court held that Appellant was trustee for Mrs. Sefton of the money and property she transferred to him; that as trustee he had wrongfully and **unlawfully taken**, transferred, or caused to be transferred to himself and to others various funds and securities owned by Mrs. Sefton as her separate property; and that Mrs. Sefton was entitled to recover approximately \$156,000.

In connection with that litigation Appellant engaged an accountant to prepare a report of his transactions with his **wife's** funds and property. In 1952 he paid the accountant \$6,600 for his services and claimed the accounting expense as a deduction in his return of personal income for 1952. The

Appeal of J. W. Sefton, Jr.

Franchise Tax Board disallowed the claimed deduction and issued the proposed assessment here in question.

Appellant does not claim that his services as trustee were part of his trade or business but contends that the expenditure was allowable under Section 17302.5 of the Revenue and Taxation Code as then in force (now Section 17252), providing as follows:

"In computing net income there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income."

This section is substantially the same as Section 23(a)(2) of the United States Internal Revenue Code of 1939.

Under Section 23(a)(2) the Federal courts have held that a payment made by a non-professional fiduciary in settlement of a suit for mismanagement is not deductible (Commissioner v. Heide, 165 Fed. 2d 699) and that attorney fees in connection with such a suit are not deductible (Commissioner v. Josephs, 168 Fed. 2d 233). The principle of these cases is that such expenses are due to the delinquency of the fiduciary and are not "necessary" to the production of income or the management, conservation, or maintenance of property held for the production of income. The expense here in question falls within the scope of those decisions.

Appellant suggests that he and his wife were engaged in a joint venture to obtain income for both of them, but there is no foundation for such a conclusion. The trial court expressly found that they were not engaged in a joint venture.

Appellant also seeks to support the claimed deduction on the ground that the audit was made to determine the individual rights of himself and his wife in commingled income producing property. This argument overlooks the fact that any commingling of the property constituted a breach of his duty as a fiduciary. To be allowable as a deduction the expense must be one resulting "from conditions which stand in the path of" the production of income, rather than an expense interposed by the wrongdoing of the taxpayer, Commissioner v. Heide, supra. Appellant cannot be heard to claim that he derived income, or expected any, from the handling of his wife's separate property and funds. The expenditure in question, therefore, was not paid or incurred for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income to him, as required by Section 17302.5 of the Code.

Appeal of J. W. Sefton, Jr.

O R D E R

Pursuant to the views expressed in the Opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to Section 18595 of the Revenue and Taxation Code that the action of the Franchise Tax Board in denying the protest of J. W. Sefton, Jr., against a proposed assessment of additional personal income tax in the amount of \$327.89 for the year 1952 be and the same is hereby sustained.

Done at Sacramento, California, this 19th day of August, 1957, by the State Board of Equalization.

Robert E. McDavid, Chairman

George R. Reilly, Member

J. H. Quinn, Member

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ATTEST: Dixwell L. Pierce, Secretary